Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Federal-State Joint Board on	)	
Universal Service	)	WC Docket No. 05-337
	)	
High-Cost Universal Service Support	)	CC Docket No. 96-45

REPLY COMMENTS OF VERIZON AND VERIZON WIRELESS

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I. INTRODUCTION AND SUMMARY.

Verizon has submitted a comprehensive Reform Plan under which the Joint Board and the Commission would use competitive bidding or reverse auctions to disburse high cost universal service funding.[2] Verizon's Reform Plan is the only proposal before the Joint Board and the Commission that will stabilize the fund permanently and rationalize high cost universal service support. In addition to controlling the unsustainable growth of the fund, and thereby reducing the financial burden on consumers, Verizon's Reform Plan will allow market forces to establish the appropriate level of support and will help eliminate the inefficiencies in the current system that undermine the effectiveness of universal service support.

Verizon's Reform Plan is not just about reducing the size of the universal service fund. Under Verizon's proposal, universal service subsidies will be more accurately targeted, both in terms of ensuring the proper *amount* of support and identifying the appropriate *areas* where

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[1] In addition to Verizon Wireless, the Verizon companies participating in this filing are the regulated, wholly owned subsidiaries of Verizon Communications Inc. (collectively "Verizon").

[2] *See Modernizing Universal Service: Verizon's Plan for Comprehensive Reform* ("Reform Plan"), attached to Comments of Verizon and Verizon Wireless, WC Docket No. 05-337, CC Docket No. 96-45 ("Verizon Comments"); *see also* Letter from Kathleen Grillo, Verizon, to Commissioner Tate and Commissioner Baum, Federal-State Joint Board on Universal Service, WC Docket No. 05-337, CC Docket No. 96-45 (Feb. 9, 2007).

support should be provided. Verizon's Reform Plan targets the right amount of support by using a market-based approach to answer the question of how much a provider should be paid to provide universal service in a given area. Verizon's Reform Plan targets support in the appropriate areas by creating a process to retarget (without increasing) support in existing subsidized areas and by making available some of the savings from reverse auctions to provide support in areas that do not receive support today but where the Commission determines support will be needed going forward. A number of commenters have endorsed Verizon's proposal, and the Joint Board should recommend that the Commission adopt it.

While parties to this proceeding overwhelmingly recognize the problems facing the high cost fund and ostensibly support efforts to control its growth, some of those same commenters propose "solutions" that will either further burden the fund or do nothing to fix the fundamental flaws with the current universal service system. For example, mandatory disaggregation of support below the study area level would only result in a larger high cost fund. Similarly, calls for eliminating the identical support rule, while an important component of comprehensive reform, would not in and of itself solve the financial strain associated with providing redundant support to multiple eligible telecommunications carriers ("ETCs"). The same is true for proposals to develop new cost studies for the distribution of high cost support, which also would involve a lengthy and time consuming process to implement with little or no attendant benefits. Unlike Verizon's Reform Plan, these proposals are not adequate solutions to the problems confronting the high cost fund and should be rejected.

The Joint Board also should reject proposals to broaden the high cost fund by adding broadband to the list of supported services or to create new broadband pilot programs. While broadband deployment is an important national priority, this goal can and should be

accomplished by other means. Such efforts include public-private partnerships that more efficiently target funds to pay for the deployment of broadband in truly unserved or underserved areas. Furthermore, the Joint Board and the Commission's first priority should be to stabilize and reform the high cost fund; until it does so, proposals to fund broadband deployment through universal service are premature.

II. THERE IS CONSENSUS THAT THE GROWTH OF THE FUND IS NOT SUSTAINABLE.

In responding to the Public Notice,[3] commenters uniformly agree with the Joint Board that the high cost fund has become unsustainable.[4] Comcast correctly observes that "the existing distribution mechanism poses a threat to the viability of the fund" and that the "size of the high-cost universal service fund continues to grow dramatically."[5] Likewise, the Missouri Public Service Commission notes that the "universal service fund is experiencing significant strain" and that "[l]ong-term efforts must be developed to rein in the explosive growth of high-cost universal service support."[6] AT&T, the New Jersey Board of Public Utilities, T-Mobile, and CenturyTel, among many others, agree that the fund has reached an unsustainable level.[7]

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3 *See Federal-State Joint Board on Universal Service Seeks Comment on Long Term, High-Cost Universal Service Reform*, Public Notice, WC Docket No. 05-337, CC Docket No. 96-45, FCC 07J-2 (rel. May 1, 2007) (the "Public Notice").

4 *Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, Recommended Decision, FCC 07J-1, ¶ 4, n11 (Fed.-State Jt. Bd., rel. May 1, 2007) ("*Recommended Decision*").

5 Comments of Comcast at 1 & 3-4 ("[T]he ongoing growth in the fund size has made the scheme unstable, unpredictable, and, as the Joint Board noted, 'unsustainable.'") ("Comcast Comments").

6 Comments of the Missouri Public Service Commission at 1 ("MoPSC Comments").

7 Comments of AT&T at 1 (noting that the fund has been "stretched to the limit" and is now "unsustainable in today's increasingly competitive telecommunications marketplace") ("AT&T Comments"); Comments of The New Jersey Board of Public Utilities ("NJBPU") at 3 ("the current program has grown beyond the intent of the Fund's stated goal of ensuring the availability of affordable telephone service for all Americans who wish to have such service")

Most commenters also agree with Chairman Martin and the Joint Board concerning the source of the fund's unsustainable growth: increased support to competitive ETCs.[8] Further, commenters generally agree that it is not the presence of competitive ETCs *per se* that is driving the fund's unsustainable growth; rather, the root cause is the current system of paying subsidies to multiple ETCs in many areas where carriers do not need subsidies in order to provide service.[9]

As a recently released study by Criterion Economics LLC confirms, "[t]he growth of CETC subsidies is a direct result of the eligibility rules under which USF funds are allocated," including rules that "permit multiple carriers to receive funds for serving the same area, allow carriers to receive subsidies for multiple telephone lines within the same household, and specify

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("NJBPU Comments"); Comments of T-Mobile at 1 ("[t]he steady erosion of the universal service contribution base and the accelerating demands placed on the high-cost program require immediate Joint Board and Commission attention ...") ("T-Mobile Comments"); Comments of CenturyTel at 2 (accurately summarizing the vast majority of commenters' positions when noting that "immediate action is required to stabilize the funding base for universal service") ("CenturyTel Comments"); *see also* Comments of the People of the State of California and the California Public Utilities Commission at 3 ("[c]hanges in the competitive landscape and technological advances have rendered the current federal universal service program outdated"); Comments of Alaska Telephone Company at 4 (recognizing that the high cost fund is now in jeopardy due to uncontrolled growth) ("Alaska Telephone Comments"); Comments of the Independent Telephone and Telecommunications Alliance at 3, 8, 10 (observing that there is a "USF growth problem," that high cost support has "risen sharply" in recent years, and that the Commission must act now to "relieve the pressure on [the] Fund") ("ITTA Comments").

[8] *See, e.g.*, CenturyTel Comments at 8; Verizon Comments at 14; ITTA Comments at 9 ("As recognized by the Joint Board in its Recommended Decision, CETCs are identified by public and private parties as the largest source of USF growth in recent years."); NJBPU Comments at 3 ("[T]he bulk of the growth [is] coming from payments to competitive ETCs"); *accord Recommended Decision*, ¶ 4 ("[T]his growth has been due to increased support provided to competitive ETCs ..."); Opening Remarks of Chairman Kevin Martin, *Federal-State Joint Board on Universal Service En Banc Meeting*, Washington, DC, p. 4 (Feb. 20, 2007) (noting that "almost all of the recent growth in high-cost universal service is largely a result of CETC access to high cost support"); *see also The Effects of Providing Universal Service Subsidies to Wireless Carriers,* Criterion Economics, LLC, Kevin W. Caves & Jeffrey A. Eisenach, at 1 (June 13, 2007) (noting that disbursements to competitive ETCs have grown at a compound annual growth rate of 185 percent since 1999, accounted for more than 90 percent of the fund's growth since 2003, and currently account for 21 percent of all disbursements from the high cost fund) ("Caves & Eisenach").

[9] *See, e.g.*, Comments of BEK Communications Cooperative at 4 ("BEK Comments"); *see also* Alaska Telephone Comments at 2-3.

that competitors receive the same subsidy per line as the incumbent serving the same territory (or 'study area'), even if they have lower costs."[10] Funding all ETCs on a "per line" basis also contributes to the unsustainable growth in the high cost fund by encouraging carriers to increase the number of lines or handsets that customers purchase in order to maximize their universal service subsidy without actually encouraging further investment in facilities.[11] The current system also puts competitive pressures on carriers that do not now draw high cost subsidies to seek ETC designations in the future, putting additional pressure on the fund.[12]

The problem with the current disbursement system is exacerbated by the identical support rule. As AT&T points out, "the federal universal service support mechanisms themselves are being stretched to the limit as duplicative USF payments to multiple CETCs escalate, expanding the size of the federal universal service fund and increasing the cost of telecommunications services for all consumers."[13] BEK Communications Cooperative notes that competitive ETCs are driving the growth in the high cost fund in part because "they receive support based on the ILECs per line support rather than based on their own costs."[14]

A. Recently Released Economic Studies Confirm That The Fund Does Not Target Support Appropriately.

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[10] Caves & Eisenach at 2.

[11] *See, e.g.*, BEK Comments at 4 ("In the case of wireless CETCs, they could be receiving support for multiple lines per household at the same per line amount as the ILEC who would typically receive only support for one line per household.").

[12] *See* Caves & Eisenach at 20 (predicting that if Cingular "continues to seek ETC status," Verizon Wireless "will be forced to follow suit") (quoting Testimony of Bill Jack Gregg, Director, Consumer Advocate Division, Public Service Commission of West Virginia, Before the Communications Subcommittee, Senate Commerce, Science, and Transportation Committee, at 11 (March 1, 2007)).

[13] AT&T Comments at 1.

[14] BEK Comments at 4; *see also* CenturyTel Comments at 6; Alaska Telephone Comments at 2-3.

Economic studies released since the opening round of comments confirm that the high cost fund fails to target support appropriately.[15] In the context of wireless ETCs, these economic studies make clear that the fund primarily funnels subsidies to areas where wireless ETCs already provide service and where other wireless carriers can and do so without universal service subsidies. Thus, contrary to the policy goals underlying the high cost fund, the current universal service disbursement scheme does not, in any meaningful manner, enhance customer choice or increase the availability of service in areas that would not be adequately served without support.

Wireless ETCs have argued that "'America is getting a great return on its investment in wireless universal service.'"[16] In support of this argument, wireless ETCs often claim that: (1) universal service subsidies have produced a "'tremendous expansion of wireless service into rural areas'";[17] and (2) wireless subsidies increase customer choice by "'[i]ntroducing the benefits of competition in rural areas.'"[18] Criterion Economics, which analyzed the actual effects of universal service subsidies on the availability of wireless service and on the introduction of consumer choice, has debunked both of these claims.

In considering the extent to which the current distribution mechanism efficiently advances the goals of universal service, Criterion Economics used data from 2003-2006 and analyzed the impact of universal service subsidies on two important variables: (1) the

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15 *See* Caves & Eisenach; *see also The Availability of Unsubscribed Wireless and Wireline Competition in Areas Receiving Universal Service Funds,* Criterion Economics, LLC, Nicholas Vantzelfde (June 13, 2007) ("Vantzelfde").

16 Caves & Eisenach at 21 (quoting at Testimony of Richard Massey, Executive VP, Corporate Secretary and General Counsel – Alltel Wireless, Before the U.S. Senate Committee on Commerce, Science, and Transportation at 7 (March 1, 2007) ("Massey Testimony")).

17 *Id.* at 21 (quoting Massey Testimony at 7).

18 *Id.* (quoting Alltel Wireless, "Wireless Universal Service," *Federal State-Joint Board on Universal Service*, Notice of Ex Parte Presentation at 11 (Jan. 11, 2007)).

availability of wireless service; and (2) the number of wireless providers from which consumers can choose. If the current fund were targeting support efficiently and in a manner consistent with the policy goals underlying the high cost program, one would expect to find that universal service disbursements have had a significant impact on the availability of mobile telephone service in high cost areas. The data and economic analysis reveal otherwise. Indeed, "[f]rom an economic perspective . . . the actual effect of USF subsidies on wireless availability and choice in rural America is likely to be far less than what a casual observer would expect, given the gross amount of the subsidy." Caves & Eisenach at 30. As currently targeted, "subsidies do not appear to result in significantly greater wireless coverage or choice." *Id.* at 42.

The Criterion Economics studies underscore at least three critical problems with the current high cost program. First, the studies conclude that the fund is not adequately directing high cost funds to consumers who need federal support: namely, consumers who would not have access to telecommunications services absent high cost support. Rather, under the current rules, competitive ETCs receive support based on the number of lines they serve in a study area – even if they were serving those lines prior to being designated as a competitive ETC. Thus, according to the Caves & Eisenach study, "a substantial proportion of CETC subsidies are expended on services provided to . . . customers who, by definition, would have received (and, indeed, already were receiving) the same services from the same carriers, even without the subsidy." *Id.* at 27-28.

Second, the studies conclude that the current mechanism fails to create incentives for carriers to increase coverage in areas that are not already served. *See id.* at 28; *see also* Vantzelfde at 14. Under the current rules, universal service subsidies are distributed to competitive ETCs based on the number of customers they serve – rather than the number

households they serve or the number of square miles of territory they cover. Thus, the fund "do[es] not provide direct incentives for carriers to make [coverage] enhancing investments." Caves & Eisenach at 28. According to the Vantzelfde study, "wireless carriers which receive no USF subsidies cover a significantly larger portion of the population in study areas receiving CETC subsidies than do the subsidized carriers." Vantzelfde at 10. Indeed, "[u]nsubsidized carriers cover 97.3% of the population, while subsidized carriers cover less than 70% of the population in these study areas." *Id.* at 10. Moreover, "of the 103.7 million pops covered by wireless CETCs, only 3.2 million people, or roughly 1.5 million households, receive coverage from subsidized carriers that is not duplicated by at least one unsubsidized carrier." *Id.* at 15. Therefore, competitive ETCs are not using universal service funds to expand wireless coverage in a meaningful way.

Third, the economic studies reveal that the current mechanism fails to increase consumer choice in a meaningful manner. As the Caves & Eisenach study points out, the current system creates incentives for wireless ETCs to "invest[] in more retail outlets, a bigger advertising budget, or other marketing activities," instead of increasing customer choice. Caves & Eisenach at 29 & 41. Indeed, as the Vantzelfde study observes, "[o]f the 103.2 million people with coverage from wireless CETCs, over 52% have coverage from more than one subsidized CETC ...," which means that "a majority of subsidies to wireless CETCs go to provide duplicative subsidized coverage" and does not necessarily enhance consumer choice. Vantzelfde at 12. In fact, as experience indicates and the economic analyses confirm, subsidies are not necessary to increase competition and customer choice. *See Id.* at 14 ("In the areas served by wireless CETCs, there is also a significant amount of unsubsidized wireline competition."). Indeed, as confirmed by Verizon Wireless and T-Mobile, which compete without the benefit of high cost

support in the vast majority of their service areas, unsubsidized carriers "have shown that it is economical to deploy infrastructure in many areas eligible for USF support without the benefit of subsidies." *Id.* at 14.

B. Subsidies Paid To Alltel And U.S. Cellular Illustrate The Problems With The Current System.

Alltel is by far the largest recipient of competitive ETC funding, receiving approximately $228 million in high cost support in 2006. Of the 867 study areas in which Alltel provides wireless service, Alltel receives high cost support in 367 of these areas. Vantzelfde at 16-18. In 187 of these supported areas, Alltel received more than $98 million in high cost support in 2006 to serve areas that are also served by other nonsubsidized wireless carriers. As a result, in those 187 areas, Alltel provides "*absolutely no incremental coverage compared with unsubsidized carriers,*" which means that in 187 study areas where it receives high cost support, Alltel does not provide any more coverage than wireless carriers that receive little or no high cost support. *Id.* at 18 (emphasis added).

When viewed from a "per covered person" basis (or "pop"), the inefficiencies in the current distribution system are even more telling. The vast majority of people in areas served by Alltel could get wireless service from unsubsidized carriers. Alltel covers approximately 79.4 million pops across its 867 study areas. *Id.* at 16. Of these, 34.7 million reside in the 367 study areas where Alltel receives high cost support. *Id.* at 18. However, there are only 265,000 wireless subscribers in areas where Alltel is the only wireless carrier; given the $228 million in high cost support that Alltel received in 2006, "this translates into approximately $860 per incremental line served." *Id.* at 18-19.

U.S. Cellular provides another example of the fundamental problems with the manner in which high cost support is currently distributed. U.S. Cellular receives high cost support in 234

of the 564 areas in which it provides wireless service. *Id.* at 20. Though U.S. Cellular received nearly $61 million in subsidies to cover these 234 study areas in 2006, the company provides little or no incremental coverage beyond what unsubsidized carriers provide in 149 of its support areas. *Id.* at 20-21. Thus, in nearly two-thirds of the areas where it receives high cost support, U.S. Cellular provides service in the same areas as carriers receiving little or no high cost support. In the 85 study areas where U.S. Cellular offers some incremental coverage, it receives $27.9 million in support, which translates to approximately $110 per incremental pop and $290 per incremental subscriber. *Id.* at 21-22.

As these examples demonstrate, the current high cost funding mechanism does not expand wireless service or increase consumer choice in an effective and efficient manner. Therefore, the Joint Board and the Commission should adopt comprehensive reform that distributes an efficient amount of support and directs that support to those areas that really need subsidies, as Verizon's Reform Plan would do.

III. VERIZON'S REFORM PLAN SHOULD BE ADOPTED.

Nearly all commenters agree that the Joint Board and the Commission must act now to reform fundamentally the manner in which high cost support is disbursed. Such reform should: (1) stabilize the fund by allowing the market to determine support levels, rather than regulators; (2) use high cost subsidies to encourage efficient investment, rather than rewarding investment that would have been made anyway without the payment of subsidies; (3) ensure access to affordable telecommunications services and adequate universal service support, rather than burdening consumers with redundant subsidies paid to multiple ETCs serving the same area; and (4) preserve and advance universal service in unserved areas by creating a process to utilize savings from universal service reform, rather than expanding the high cost fund before any savings have been realized. Only Verizon's Reform Plan satisfies these objectives as well as

promotes broadband deployment by awarding a flat amount of subsidy applied across technologies, as explained in greater detail below.

The cornerstone of Verizon's Reform Plan is the gradual introduction of competitive bidding or reverse auctions to disburse high cost support. Many parties in this proceeding support reverse auctions, recognizing that competitive bidding is the best way to stabilize and modernize the high cost fund, while preserving and advancing universal service. Reverse auctions are a proven mechanism that allows market forces to set the appropriate level of support without the use of complicated and inexact cost models.[19] Rather than encouraging providers to simply increase the number of lines they serve, Verizon's plan ends the problem of duplicative support through multiple handsets by providing a flat amount of subsidy for the service term. In this way, auctions encourage efficiency by the subsidized ETC in order to maximize profit. Verizon's proposal also effectively eliminates the illogical identical support rule by forcing carriers to prepare bids based on their own business plans rather than based on a regulator's calculation of cost – a result that a number of commenters support.[20]

Verizon has submitted a detailed plan for implementing auctions in a phased manner that starts with auctions for wireless ETCs and then proceeds to auctions for wireline ETCs, resulting in the funding of only two ETCs in a given service area in the first phases of reform – one

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[19] Although Alltel claims that a properly developed forward looking economic cost model could be used for purposes of reverse auctions, *see* James W. Stegeman, Dr. Steve Parsons, & Mike Wilson, "Proposal for a Competitive and Efficient Universal Service High-Cost Approach," at 8, no such model would be necessary under Verizon's reverse auction proposal. In fact, if the Joint Board and the Commission were to implement a system of competitive bidding as Verizon has proposed, the concept of "costs" becomes immaterial, and there would no longer be any reason for the Joint Board and the Commission to struggle with cost modeling and all of the contentious issues that cost models entail. *See* Verizon Comments at 10-11.

[20] *See, e.g.*, NJBPU Comments at 6, 11; *see also* Comments of the National Association of State Utility Consumer Advocates at 20 ("NASUCA Comments "); Comments of the National Exchange Carrier Association, Inc. at 9-10 ("NECA Comments").

wireless and the other wireline. Reverse auctions further the statutory universal service goals established by Congress. Specifically, reverse auctions meet the goals of Section 254 and satisfy the concerns expressed by the Tenth Circuit in *Qwest II*,[21] including concerns about the sufficiency of universal service support, the establishment of specific and predictable support mechanisms, and the affordability of rates.

Many parties in this proceeding express their support for auctions as a means to end the fund's unsustainable growth, promote stability, and determine the necessary amount of support based on competitively determined costs. Comcast notes that "[a] properly designed reverse auction would further the goal of sustainability by encouraging provision of service in high cost areas at a lower cost than under the current system."[22] Though other parties support other auction plans, many support auctions generally as a way to gauge the real, most efficient cost to provide service in a given service area.[23]

Parties also support Verizon's arguments that reverse auctions will further the statutory goals of universal service. Comcast notes that a "reverse auction would further the statutory goal of sustainability" and would "serve the interests of telecommunications consumers."[24] The New Jersey Board of Public Utilities supports Verizon's proposal and opines that it "has the potential

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21 *Qwest Communications International, Inc. v. FCC*, 398 F.3d 1222 (10th Cir. 2005).

22 Comcast Comments at 5.

23 T-Mobile Comments at 3 (observing that "[r]everse auctions would distribute support to the carrier(s) offering to provide services for the least amount of universal service support, thereby driving all carriers toward efficient operations, minimizing the burden on the high-cost fund and restraining its growth."); *see also* Comments of Sprint Nextel at 2; Comments of Windstream Communications at 4-5 ("Windstream Comments"); Comments of the Nebraska Public Service Commission ("NPSC") at 4 ("NPSC Comments").

24 Comcast Comments at 5.

to significantly reduce the size of the Fund, yet make a sufficient amount [of support] available to meet the Universal Service goals of the 1996 Telecommunications Act."[25]

In addition, parties support a gradual approach to phasing in auctions that exercises caution in implementing the new system. Consistent with Verizon's Reform Plan, Windstream notes that if the Commission were to implement auctions, "a logical place to start would be to use auctions on a trial basis in areas with multiple mobile CETCs to select the one mobile CETC that should receive support."[26]

Some commenters oppose reverse auctions, expressing concern that: (1) service quality and the availability of service would decline under a reverse auction system;[27] (2) reverse auctions would not encourage investment;[28] and (3) a reverse auction system would raise the potential for conflict with state laws.[29] However, these concerns are misguided, and no evidence has been presented that any of these harms will actually come to pass under a properly constructed reverse auction system.

Indeed, under Verizon's Reform Plan, service quality and the availability of service will be ensured by spelling out the applicable service requirements in the Request for Quote ("RFQ") and memorializing these requirements in a contract with the winning bidder.[30] Verizon also has proposed that the Commission consult with state commissions to create a "model" RFQ and a

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25 NJBPU Comments at 7.

26 Windstream Comments at 4.

27 Comments of Alexicon Telecommunications Consulting at 5 ("Alexicon Comments"); Comments of CoBank, ACB at 3; Comments of the ICORE Companies at 5-6; Comments of Telcom Consulting Associates at 4.

28 Alexicon Comments at 5.

29 *Id.* at 5.

30 *See* Reform Plan at 9-10 & 16-17.

model contract, which would allow regulators to work cooperatively with the states to ensure that service quality and service availability are adequately protected. Under Verizon's proposal, the Commission and state regulators also would continue to have authority to investigate and penalize a winning bidder that fails to adhere to its universal service commitments.

A reverse auction system also will encourage investment, as the experience in other countries has confirmed. Countries utilizing reverse auctions report an increase in deployment of telecommunications services and increased universal service coverage stemming from the use of reverse auctions.[31] In addition, implementation of a program to retarget existing support and permit funding in high cost areas not receiving support today, as described *infra*, will result in additional investment that would otherwise not be made. This is in stark contrast to today's system, which, as Caves & Eisenach show, has done little to increase the availability of wireless services.[32]

Lastly, Verizon recognizes that it may be the case that reverse auctions would function better if certain state obligations are modified. With that in mind, Verizon encourages the Commission to consult with state commissions regarding whether it is appropriate to relieve some incumbent LEC obligations, like any carrier of last resort requirements that may exist in a given state, if the incumbent LEC is not the winning bidder in an auction.

A properly designed and implemented reverse auction system will result in a universal service program that reduces the size of the fund while encouraging targeted investment by telecommunications companies and increased universal service coverage.

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31 *See* James Stegeman, Dr. Steve Parsons, Robert Frieden, and Mike Wilson, *Controlling Universal Service Funding and Promoting Compatition Through Reverse Auctions*, 2.

32 *See* Caves & Eisenach at 21-28.

IV. VERIZON'S REFORM PLAN IS THE MOST EFFICIENT WAY TO TARGET SUPPORT TO AREAS WHERE IT IS NEEDED MOST.

Parties in this proceeding, most notably Embarq, complain that the current universal service funding mechanism does not fund or insufficiently funds many high cost areas.[33] Verizon's Reform Plan addresses this concern by including a way to retarget existing high cost support to ensure that subsidies go to areas that would not be adequately served without support and a process to fund high cost areas that do not receive support today but that the Commission determines will need support going forward.

Under Verizon's proposal, as described above, an incumbent LEC should be given a limited option to retarget existing high cost support by seeking approval from its state commission to disaggregate support in its study areas – on a voluntary basis – to either the wire center level or no more than two cost zones per wire center. *See* Verizon's Comments at 6. This approach would ensure that customers in high cost outlaying areas surrounding a town continue to have access to affordable telecommunications service when customers in the town itself are being served by the incumbent LEC's competitors.

Verizon also proposes to use a portion of the savings generated by the auction process to target support to any high cost areas that the Commission determines will need support going forward but do not receive subsidies today. The Commission could use the results of the initial auctions to create a statistical analysis to determine how much support would reasonably be needed to provide universal service in any such area that the Commission determines will need support going forward but does not receive high cost support today. This analysis would rank these areas from highest to lowest in order of the estimated cost of support, invite nominations for auction, and then the Commission could hold auctions to select a provider of universal

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[33] Embarq Comments at 14.

service for those nominated areas. A wireless carrier could nominate an area for "new" wireless funding only if there is no wireless carrier providing service in the area.. These areas, by definition, do not need subsidies to obtain service. This is an efficient and rational approach to providing support in high cost areas that do not receive such support today, while at the same time stabilizing and rationalizing the current high cost program and helping to expand wireless service into areas where there is no coverage today.

The same cannot be said about proposals from other parties seeking to expand service in certain high cost areas. For example, AT&T proposes that the Commission adopt a pilot program to encourage wireless facilities and services in areas where those services are not currently available.[34] However, merely adding programs, the cost of which is to be borne by consumers, in the absence of more fundamental reforms that would better target subsidies is not the answer.

As an initial matter, it should be noted that there are very few areas of the country without wireless service. A recent Commission report shows that 98% of counties in the United States are served by at least three wireless providers.[35] Nevertheless, the fact remains that in certain areas the cost of providing service is prohibitive and no wireless carrier yet provides coverage. It is a laudable goal to encourage wireless deployment in those areas. And Verizon's proposal to make available part of the savings from reverse auctions to fund high cost areas not receiving support today would directly advance that goal in a more measured way that is closely tied to the purpose of the universal service program.

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34 *See* AT&T Comments at 6.

35 *Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993; Annual Report and Analysis of Competitive Market Conditions with Respect to Commercial Mobile Services*, Eleventh Report, WT Docket No. 06-17, 21 FCC Rcd 10947 (2006).

V. THE COMMISSION SHOULD REJECT PROPOSALS THAT EXACERBATE OR DO NOT ADDRESS THE MAJOR PROBLEMS WITH THE HIGH COST FUND.

Commenters generally agree that the Joint Board and the Commission must take immediate steps to reform the high cost fund.[36] Nonetheless, some commenters have used this proceeding to advance "reforms" that would solve none of the problems confronting the high cost fund and would only further expand universal service disbursements and make matters worse. Other commenters express support for proposals that, while ostensibly aimed at curtailing the growth of the high cost fund and proposed as a step in the right direction, could very well have the opposite effect and in any event do not solve the fundamental problems confronting the high cost fund. The Joint Board should reject these proposals.

A. Mandatory Disaggregation And The Creation of A New Cost Model Would Increase Growth In The High Cost Fund.

Several commenters propose that the Commission implement mandatory disaggregation by which universal service subsidies would be paid below the study area level.[37] The Commission should reject such proposals. As RTG and BEK Communications observe, "[t]here is no need for the Commission to force disaggregation on incumbent rural carriers."[38] In fact,

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[36] At least one commenter has indicated that the Commission should maintain the status quo. Comments of the Rural Telecommunications Group at 5 ("RTG believes that universal service support should remain available to all qualifying competitors on a technologically neutral basis.") ("RTG Comments"). As explained above, however – and as recognized by nearly all other commenters – maintaining the status quo is simply not a viable option.

[37] *See* Comments of Dobson Cellular at 2 ("The Joint Board should recommend that support be disaggregated to the most granular level practicable.") ("Dobson Comments"); NPSC Comments at 8 ("Disaggregation should be mandatory for all carriers.") ("NPSC Comments"); Comments of Comspanusa at 8 ("Comspan believes that all carriers should be required to disaggregate support.") ("Comspanusa Comments").

[38] RTG Comments at 4; *see also* Comments of the Rural Iowa Independent Telephone Association at 5 ("The Commission should not force carriers to disaggregate . . . .").

mandatory disaggregation would only exacerbate the problems facing the high cost fund.[39] Commenters also correctly point out that mandatory "[d]isaggregation will merely shift support around like a high cost shell game, rather than reduce support or more effectively target support."[40]

Accordingly, the Joint Board should reject mandatory disaggregation proposals. Instead, the Joint Board should adopt Verizon's proposal to retarget (without increasing) existing high cost support to ensure that subsidies are appropriately targeted to areas that would not be adequately served without support by giving incumbent LECs a limited option to disaggregate support below the study area level. As explained more fully in Verizon's opening comments, the Commission should allow incumbent LECs to seek approval from their state commissions to disaggregate support in its study areas – on a voluntary basis – to either the wire center level or no more than two cost zones per wire center. *See* Verizon's Comments at 6. This approach would help solve the problem identified by Embarq - competitors' winning customers in a town (the so-called doughnut hole), while incumbent LECs are left to serve customers in the most costly outlaying areas (the doughnut) with little or no universal service support.[41]

These same problems are inherent with proposals that the Joint Board and the Commission engage in a costly and time-consuming exercise of establishing a new cost model

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39 *See, e.g.*, BEK Comments at 5 ("requiring all carriers to disaggregate may result in wireless and other CETCs . . . target[ing] the higher cost areas in order to receive higher support per line"); Comments of the National Telecommunications Cooperative Association at 17 ("NTCA Comments").

40 RTG Comments at 4-5.

41 *See* Letter from Brian K. Staihr, David C. Bartlett, and Jeffrey S. Lanning, Embarq, to Commissioner Tate and Commissioner Baum, Federal-State Joint Board on Universal Service, WC Docket No 05-337, CC Docket No. 96-45 (April 12, 2007).

that would be used to disburse high cost support.[42] A significant number of commenters echo Verizon's opening comments and urge the Joint Board and the Commission to reject reforms that are contingent on a cost model approach. Cost models require an enormous investment of time and resources that would take too long to implement and would merely result in another round of costly and lengthy litigation over the accuracy of the model and its inputs. And in any event, a new cost model would not address many of the problems facing the high cost fund.

As an initial matter, many commenters explain that GIS and network cost models are inaccurate and untested. According to NTCA, "[w]hile computing capabilities have increased greatly in the last 10 years and geographic location data may be more readily available for wireline modeling, the challenges associated with developing accurate cost models are still formidable."[43] CenturyTel agrees, noting that "[t]hese new models remain largely untested for determining support in rural markets."[44] Other parties explain that developing cost models is a highly resource intensive proposition.[45] Indeed, advocates of the development of a new

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[42] *See* T-Mobile Comments at 7 (opining that "[t]he Joint Board should recommend utilization of GIS technology and cost modeling techniques to enable the Commission to target support only to those areas most in need."); Comments of Alltel Wireless at 2 (supporting the use of an economic cost methodology for determining the level of universal service support); Comspanusa Comments at 8 ("Comspan supports more advanced modeling technologies."); Dobson Comments at 5 ("Network cost modeling techniques present the best way to determine the relative cost of service in different geographic areas, which is the necessary first step in determining universal service support.").

[43] NTCA Comments at 12. CenturyTel also observed that "there have been few opportunities to see how such tools work in practice, and whether they accurately predict where support is needed. In contrast, there already are examples in the record of cost modeling failing to adequately project either true costs or necessary support levels." CenturyTel Comments at 20.

[44] CenturyTel Comments at 19; *see also* Comments of the Rural Independent Competitive Alliance at 11-12 (explaining that "validation of a model requires that its predictions be tested against a statistically valid sample of actual calculations").

[45] NTCA Comments at 12 ("Cost models are intellectually appealing but are costly to build and maintain."). "With telecommunications technology rapidly changing, the use of GIS technology and network cost modeling would be very difficult to develop and maintain." BEK Comments at 5.

universal service cost model express the view that a "completed platform" would not be available until sometime in 2008, which is considerably more optimistic than prior industry experience and their own earlier predictions.[46] In addition, cost models are time sensitive and thus "perishable."[47] And, as other commenters point out, cost models are susceptible to manipulation.[48]

The proponents of cost modeling also acknowledge the challenges inherent in such an approach. Even assuming the Joint Board and the Commission could agree on a proper model framework and design criteria within a reasonable period of time (which is hardly certain based on past industry experience with cost models), cost modeling requires extensive "data input and maintenance."[49] In particular, data would need to be developed and maintained for a host of critical model inputs, including: operational costs; demand data; attribution or allocation methods for indirect capital expenses; network material prices, capabilities, and constraints; internal labor rates; external contractor rates; depreciation lives; financial data, such as asset lives

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46 James W. Stegeman, Dr. Steve Parsons, & Mike Wilson, "Proposal for a Competitive and Efficient Universal Service High-Cost Approach," at 4; *but see* Testimony of James Stegeman, CostQuest Associates, Federal-State Joint Board on Universal Service (Feb. 20, 2007) (noting that it would take two years to develop a cost model). No explanation has been given for this new found optimism about the date by which a new cost model could be completed.

47 NTCA Comments at 13 ("This work is time consuming, labor intensive, and is perishable, (i.e., it is time sensitive). Accuracy demands granularity, granularity requires capturing large amounts of data, and greater accuracy requires greater detail. All of which means that models are resource intensive, take lots of time to develop and are expensive."); *id.* at 14 ("Without timely adjustments to reflect changes in relationships among the multitude of factors used by the model and updates to cost factors the model will become irrelevant.").

48 "As with prior modeling processes . . . the 'new' technology presumably provides the capability to identify high cost to serve areas below the wire center level. As with all other modeling processes, this latest effort is likely susceptible to manipulation of results based on inputs and model design." Comments of Fred Williamson & Associates at 25 ("FWA Comments"); *see also* Comments of NECA at 8-9 (explaining that cost models are too complex to update and administer) ("NECA Comments").

49 James W. Stegeman, Dr. Steve Parsons, & Mike Wilson, "Proposal for a Competitive and Efficient Universal Service High-Cost Approach," at 17.

and the cost of money; engineering design parameters, etc.[50] In short, developing the appropriate inputs to a cost model would be as difficult, time consuming, and contentious as devising the model itself.

In addition to these challenges, starting down the path of creating a new universal service cost model in the absence of more meaningful reforms would merely perpetuate many of the problems with the current distribution system. This approach would allow carriers to continue receiving subsidies on a "per line" basis and would continue redundant support of multiple ETCs in the same area.

B. Eliminating The Identical Support Rule In Isolation Would Not Solve The Fundamental Problems Confronting The High Cost Fund.

While Verizon and other commenters fully support eliminating the identical support rule, doing so in isolation will not solve many of the pressing problems facing the high cost fund.[51] As Verizon explained more fully in its opening comments, it is critical that elimination of the identical support rule be part of comprehensive universal service reform.[52] Merely eliminating the identical support rule and replacing it with a system under which competitive ETCs would receive support based on their individual, actual costs – without other reforms – could actually increase the financial pressures on the fund. First, it would produce endless rounds of litigation over ETC claims that their "costs" are higher than (or at the very lest comparable to) those of the incumbent LEC's.[53] Second, and even more fundamentally, elimination of the identical support

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50 *Id.*

51 *See, e.g.*, Verizon Comments at 14.

52 *Id.*

53 James W. Stegeman, Dr. Steve Parsons, & Mike Wilson, "Proposal for a Competitive and Efficient Universal Service High-Cost Approach," at 36-38 (referencing a 2006 Wireless CETC Cost Development Case Study that purports to reflect that the costs of a wireless ETC "are comparable, on a consolidated basis, to that of the incumbent provider's costs in these states").

rule by itself would continue to allow carriers to receive subsidies on a "per line" basis and would perpetuate, if not exacerbate, the redundant support of multiple ETCs in the same area. As a result, eliminating the rule *by itself* would not resolve the problem or bring the spiraling growth in the cost of the fund under control.

C. CTIA's Reverse Auction Proposal Is Flawed.

While a properly designed reverse auction proposal such as Verizon's proposal would stabilize and modernize the high cost fund, CTIA's "winner takes more" approach to reverse auctions would not fix the problems facing the high cost fund. A diverse group of commenters agree with Verizon that CTIA's approach to reverse auctions is flawed. As Embarq states, "[w]ith regard to the problem of excessive, redundant support to multiple carriers serving a single area, CTIA's proposed 'winner take more' version of a reverse auction does nothing to address this key issue."[54] OPASTCO also urges the Joint Board to "reject CTIA's self-serving 'winner gets more' approach to reverse auctions" because it "would allow all existing competitive ETCs to continue to receive high-cost support."[55]

At a fundamental level, and as at least one commenter points out, the problem with CTIA's proposal is that it "would fail to control growth in the fund."[56] Not surprisingly, "the CTIA proposal does not address the continuing growth in CETCs, which is the primary

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54 Embarq Comments at 19; *accord* Comments of Organization for the Promotion and Advancement of Small Telecommunications Companies at 14 (CTIA's proposal "would only perpetuate the inefficiencies that exist in the present system where, in many instances, multiple wireless carriers in sparsely populated rural service areas are receiving support.") ("OPASTCO Comments").

55 OPASTCO Comments at iii.

56 Comments of the Nebraska Rural Independent Companies and the South Dakota Telecommunications Association at 19.

contributor to fund growth at this time."[57] More specifically, it would perpetuate the current problem by which every line and handset are counted the same for subsidy purposes, whereby, for example, a family with one wireline connection that purchases five new wireless handsets on a family plan has increased the USF support for that family by a factor of five. Thus, CTIA's "proposal is antithetical to the goals of establishing an explicit, predictable and sufficient support mechanism because such a proposal exacerbates—rather than corrects—the" important and pressing problems facing the high cost fund.[58]

VI. THERE ARE MORE EFFECTIVE AND EFFICIENT WAYS TO ENCOURAGE BROADBAND DEPLOYMENT THAN ADDING BROADBAND TO THE FUND.

Verizon actively supports and finances the deployment of broadband services and applauds the Commission's deregulatory policies with regard to broadband.[59] Because of these policies, broadband has been expanding rapidly as companies like Verizon invest billions of dollars in high quality, high speed networks. In addition, Verizon's reverse auction proposal will enhance deployment of advanced services. However, adopting broadband as a supported service or creating new broadband "pilot programs" are the wrong approaches to encouraging broadband

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57 *Id.*

58 *See* Embarq Comments at 19.

59 *See Appropriate Framework for Broadband Access to the Internet Over Wireline Facilities,* Report and Order and Notice of Proposed Rulemaking, 20 FCC Rcd 14853 (2005) (treating DSL Internet access as an information service and permitting wireline carriers to offer the underlying broadband transmission service as private carriage, both under Title I of the Communications Act), *petitions for review pending, Time Warner Telecom, Inc. v. FCC,* Nos. 05-4769, *et al.* (3rd Cir.); *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers,* Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, 18 FCC Rcd 16978 (2003) (eliminating obligation to provide line sharing), *vacated in part and remanded, United States Telecom Ass'n v. FCC,* 359 F.3d 554 (D.C. Cir. 2004); *Petition for Forbearance of the Verizon Telephone Companies Pursuant to 47 U.S.C. § 160(c),* Memorandum Opinion and Order, 19 FCC Rcd 21496 (2004) (forbearing from any section 271 obligation to provide access to fiber networks).

deployment. Focusing on solutions that will fix broadband access gaps at the local level would be much more efficient and effective.[60]

Verizon's reverse auction proposal will encourage the deployment of broadband capable infrastructure because it would provide the winning bidder with a flat amount of subsidy that is not tied to the deployment of any specific technology. Consequently, the winning bidder would be free to use the subsidy in any way that is consistent with its own business model, as long as it meets its universal service obligations. Providers would have the incentive to deploy facilities that are capable of providing advanced services in addition to supported services as a way to increase revenue streams from their networks. Thus, Verizon's reverse auction proposal would have the secondary effect of improving broadband coverage and availability.

Some commenters wrongly contend that increased broadband coverage will follow if broadband is added to the supported services list.[61] However, as Verizon noted in its initial comments, the existing universal service program is ill-suited to funding the initial deployment of infrastructure, which requires significant upfront capital expenditures. Rather, the fund has been designed to maintain a consistent level of service that already exists and ensure ongoing support for affordable access in high cost areas.

Verizon also agrees with commenters that adopting broadband as a supported service would lead to even greater problems with fund stability and sustainability.[62] Time Warner Cable correctly notes that while "the Joint Board's other reforms are appropriately intended to 'rein in the explosive growth in high-cost universal service support disbursements,' providing new

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60 *See, e.g.*, OPASTCO Comments at 20.

61 *See* Comments of Consumers Union, Consumer Federation of America and Free Press at 13-34; OPASTCO Comments at 20-26.

62 Comments of RICA at 15; T-Mobile Comments at 11; Windstream Comments at 10; RTG Comments at 6.

support for broadband services would have precisely the opposite effect."[63] The NJBPU explains that "[f]unding broadband would only serve to replace the current inequitable redistribution of funds from urban to rural states for voice services, with a (potentially more expensive) fund to deploy broadband services in those same rural state."[64] A number of other commenters also agree that adding broadband to the list of supported services would move the Commission in the wrong direction and only exacerbate the current funding problems.[65]

Other parties propose that the Commission create new funds to improve broadband coverage. AT&T proposes a new "pilot program" to disburse funds (as much as $1 billion annually) to providers that promise to deploy wireless services to unserved or underserved areas.[66] But AT&T's proposal is not a "pilot program" at all; it is merely a new $1 billion broadband fund that will increase the demand on the already unsustainable fund. In tension with its own proposal, AT&T acknowledges that the Commission must reduce – *not increase* – universal service fund disbursements before taking on any additional disbursement obligations.[67] Alltel has proposed a $25 million dollar pilot program to support broadband services.[68] Like AT&T's plan, Alltel's proposal appears to throw money at broadband deployment without trying

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63 Comments of Time Warner Cable at 2 (footnote omitted).

64 NJBPU Comments at 5.

65 *See, e.g.*, Comcast Comments at 6 (noting that it would be "premature" for the Commission to add broadband to the list of support services before it "implements a plan for fundamental reform."); Comments of the National Cable & Telecommunications Association at 3.

66 *See* AT&T Comments at 6.

67 *See id.* ("Adding broadband and wireless to the mix without fundamental reform of the high cost support regime will only increase the strain on an already broken system . . . .").

68 *See* Letter from Gene DeJordy, Steve Mowery, and Mark Rubin, Alltel Wireless, to Commissioner Tate and Commissioner Baum, Federal-State Joint Board on Universal Service, WC Docket No. 05-337, CC Docket No. 96-45, at Attachment, at 1 (Feb. 16, 2007).

to understand more globally why certain areas may not enjoy broadband access and creates a new entitlement for carriers, the cost of which would be borne by consumers. AT&T's and Alltel's proposals to create new funding programs ignore the central purpose of this proceeding: to control, not increase, universal service fund disbursements.

Rather than adding broadband to the supported services list or funding "pilot programs," the Commission should encourage broadband deployment in other, more effective ways. Public-private partnerships like ConnectKentucky that identify broadband service gaps and work locally to eliminate those gaps have shown amazing promise in increasing broadband deployment at the state level. By the end of this year, nearly 100% of Kentucky residents will have access to broadband services because of the efforts of this partnership. Iowa also has created incentives for broadband providers to expand coverage in rural areas, as a result of which 95.3% of rural communities in Iowa currently have high-speed Internet access as compared to 72.6% in 2004.[69] In addition, as the NJBPU notes, other programs, including Rural Utilities Service loans and tax incentives, exist to fund broadband deployment and are better suited than the high cost fund to accomplish that goal.[70]

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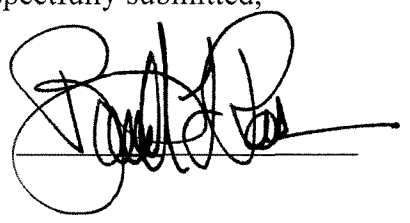
[69] *See Assessing High-Speed Internet Access In the State of Iowa: Fifth Assessment*, A Report By The Iowa Utilities Board, 1-4 (May 2006) (available at http://www.state.ia.us/government/com/util/telecom/high_speed_internet.html).

[70] NJBPU Comments at 5.

VII. CONCLUSION

As supported by commenters in this proceeding, the Joint Board and the Commission should adopt Verizon's Reform Plan and phase in competitive bidding for high cost support.

Respectfully submitted,

By: 

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